

Decision 01-11-003 November 8, 2001

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the
Commission's Own Motion into the
Establishment of a Rate Case Plan for Small Local
Exchange Carriers.

Rulemaking 97-06-038
(Filed June 25, 1997)

O P I N I O N

A. Summary

A rate case plan (RCP) with scheduled cost-of-service reviews for the 18 small Local Exchange Carriers (LECs) listed in Appendix A to the rulemaking proceeding shall not be adopted at this time.

B. Background

Prior to the issuance of Decision (D.) 89-10-031¹ in 1989, the basic regulatory framework for large, midsize, and small LECs² in California had changed very little since this Commission began regulating telecommunications. This basic regulatory framework relied on traditional cost-of-service regulation,

¹ 33 CPUC2d 43 (1989).

² The large LECs consisted of GTE California Incorporated and Pacific Bell. The mid-size LECs consisted of Citizens Utilities Company of California, Contel of California, Inc., and Roseville Telephone Company. The small LECs consisted of all the remaining certificated LECs ranging in size from Pinnacles Telephone Company with approximately 180 access lines to Sierra Telephone Company with approximately 18,000 access lines.

commonly known as rate base and rate-of-return regulation, to set rates for the LECs.

Until Resolution A-3792 was issued on May 19, 1970, all LECs were required to seek general rate changes through an application process. This resolution changed the process for small LECs to seek general rate changes from an application to a simplified advice letter process. Those LECs with less than \$50,000 in annual intrastate operating revenues were authorized to utilize the simplified process. This revenue limit for the simplified advice letter process was increased from \$50,000 to \$150,000 on September 24, 1974 pursuant to Resolution A-4314 and to \$750,000 on August 8, 1978, pursuant to Resolution M-4701. Resolution M-4701 also limited the number of general rate increase filings a small LEC may file under the simplified process to one every two years.

By Resolution T-10408, dated May 19, 1981, the annual operating revenue definition was relaxed by excluding all toll revenue from the \$750,000 annual operating revenue limit. This enabled more small LECs to qualify for the simplified advice letter process. Subsequently, in 1982, the operating revenue limit was eliminated for the 19 smallest LECs because no LEC eligible under the annual revenue exemption had used the simplified advice letter process.³

Our traditional cost-of-service regulation was challenged based on changes in the telecommunications industry and the California marketplace that occurred in the 1980's from technological innovations and regulatory efforts to promote competition and market principles in the telecommunications marketplace. In response to these changing industry conditions, we replaced the large LECs

³ 9 CPUC2d 603 at 606 (1982).

general rate case application proceedings in 1989 with a New Regulatory Framework (NRF).⁴ The NRF started an incentive-based regulatory process centered on a price cap indexing mechanism that provided a sharing between ratepayers and shareholders. The mid-size LECs had either changed or were in the process of changing from traditional cost-of-service to NRF regulation.

Up to that time, most of the small LECs had not had a general rate review for seven to eleven years. To the extreme, three of the small LECs have not had a rate proceeding since the 1960's, approximately 30 years. Because the returns actually earned by the small LECs under the traditional cost-of-service regulation were substantially higher than their authorized returns⁵ the small LECs, now numbering 18, were required to file general rate cases and, to the extent they wished, applications to adopt NRF, no later than December 31, 1995.⁶ The only exception to this requirement was the Telephone Utilities of Eastern Oregon, which serves approximately 102 access lines as an incidental part of its New Pine Creek service area, is located on the California-Oregon boarder. The simplified advice letter process was used by 12 of the small LECs and the application process by five small LECs. All 17 of the small LECs that filed general rate cases opted to continue with the traditional cost-of-service regulation.

⁴ 33 CPUC2d 43 (1989).

⁵ For example, one small LEC authorized a 13.0% return actually realized a 26.9% return in 1991.

⁶ 56 CPUC2d 117 at 289 (1994).

C. Issuance of the Rulemaking Proceeding

The small LECs' revenue stream was becoming more volatile than in the past with the small LECs continued use of traditional cost-of-service regulation, dependency on settlements with the NRF utilities, and from the basic rate impacts of the California High Cost Fund (CHCF).⁷ To assure a reasonable balance between the interests of small LECs under the traditional cost-of-service regulation and their respective ratepayers in this changing telecommunications environment, we opened this rulemaking proceeding in 1997 with the intent of establishing a small LEC RCP with scheduled cost-of-service reviews.

D. Discussion

A proposed three-year cycle RCP was attached to this rulemaking proceeding as Appendix B for comment by the small LECs and all interested parties. All 18 of the small LECs submitted comments between August 28, 1997 and September 2, 1997; nine of the 18 small LECs and AT&T Communications of California, Inc. submitted reply comments on September 30, 1997.

A proposed decision was prepared on February 17, 1998. However, it was not issued because of ongoing regulatory changes being considered and ordered by both the Commission and the Federal Communications Commission (FCC). These ongoing regulatory changes included Commission modifications to the NRF,⁸ consideration of the elimination of settlement pools which account, in

⁷ A source of supplemental revenues to the small LECs whose basic exchange access line service rates would otherwise be increased to levels that would threaten universal service.

⁸ RE: Alternative Regulatory Framework for Local Exchange Carriers, Order Instituting Investigation (OII) 87-11-033, issued in November 1987.

most cases, to more than 50% of the small LECs intrastate revenues,⁹ changes to General Order 96-A that governs tariff schedules and procedures in filing for increased rates,¹⁰ and the deregulation of pay telephones pursuant to FCC Docket 96-388, dated September 20, 1996 and Commission Resolution T-16802, dated September 3, 1997.

The May 3, 2001 issuance of D.01-05-031¹¹ established a replacement program for funding the small LEC's intrastate revenue requirement from a traditional settlement pool to the CHCF-A program, representing 30% to 80% of the intrastate revenue requirement of each small LEC.¹² The CHCF-A program is intended to protect ratepayers from inefficiencies and excessive earnings of the small LECs by requiring them to comply with a rate increase requirement, a means test, and a waterfall provision. For example, the rate increase requirement requires the small LECs that draw from the fund to submit themselves to periodic Commission scrutiny of their operations and earnings. The means test ensures that draws from the fund do not result in intrastate rates of return in excess of those authorized by the Commission.

⁹ RE: Joint Application for Approval of Settlement Transition Agreement and Implementation of Replacement Funding for Small Local Exchange Carriers, A.99-09-044, filed in September of 1999.

¹⁰ RE: Rulemaking for Purposes of Revising General Order 96-A, Rulemaking 98-07-038, issued in July of 1998.

¹¹ A final decision on A.99-09-044, RE: Joint Application for Approval of Settlement Transition Agreement and Implementation of Replacement Funding for Small Local Exchange Carriers.

¹² D.01-05-031 at p. 4, and D.01-02-018 at 13 (citing Exh.2, p. 6).

The waterfall provision provides the small LECs with the incentive to file a cost-of-service review while funding levels are still high. This is because a small LEC receiving funds from the CHCF-A may receive 100% of the funding requirement for the first three years after a Commission order in a general rate case, but then may receive only 80% the fourth year and 50% the fifth year. After the fifth year, it receives no funding at all unless the waterfall has been reset in another general rate case or other Commission order. A small LEC may avoid these automatic reductions in CHCF-A funding by filing a General Rate Case (GRC) before the waterfall initiates its funding reduction.

E. Conclusion

With the issuance of D.01-05-031, 13 of the 17 small LECs utilizing the CHCF-A process are expected to file general rate cases by 2002 and to continue with such filings on a periodic basis to avoid a substantial reduction in their intrastate revenue requirement as a result of the waterfall provision of the CHCF-A. The remaining four small LECs¹³ are expected to file GRCs subsequently in order to maintain their CHCF-A eligibility. Only CenturyTel of Eastern Oregon¹⁴ is not expected to file a GRC because it is not a participant of CHCF-A.

¹³ Citizens Telecommunications Co. of the Golden State, GTE West Coast, Inc. now known as Verizon West Coast Inc., Citizens Telecommunications Co. of Tuolumne, and Winterhaven Telephone Company.

¹⁴ An Oregon corporation serving approximately 102 access lines on the California side of its New Pine Creek area located on the California-Oregon boarder through a portion of its Lakeview exchange. Annual California revenues were estimated to be no more than \$15,000.

The transitional regulatory change within the telecommunications arena has subsided and D.01-05-031 has established a process for the small LECs to voluntarily submit to periodic regulatory reviews of their operations and earnings. Hence, the need to establish a RCP for the small LECs with scheduled cost-of-service reviews at the time this rulemaking proceeding was issued has been mitigated and no longer necessary. No further action is needed by the Commission at this time to require or encourage the small LECs to submit

periodic general rate case filings. As to the sole LEC not expected to file a GRC, the Commission's Telecommunications Division Director should monitor the operations and earnings of CenturyTel of Eastern Oregon, Inc. on a yearly basis and upon the appearance of imbalance between the operations and earnings of the small LEC and its ratepayers, should prepare a proposed investigation into the operations and earnings of the small LEC for Commission consideration. This rulemaking proceeding should be closed.

F. Comments on Draft Decision

The draft decision of the Administrative Law Judge in this matter was mailed on October 5, 2001, to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Commission's Rules of Practice and Procedure. Joint comments were filed on October 25, 2001, by 14 of the small independent telephone companies. The comments did not result in any changes to the draft decision.

Findings of Fact

1. The basic regulatory framework relied on traditional cost-of-service regulation to set rates for the LECs.
2. NRF replaced the basic regulatory framework with an incentive-based regulatory process for the large and mid-size LECs.
3. The small LECs continue to be regulated under traditional cost-of-service regulation.
4. D.01-05-031 established a replacement program for funding the small LECs intrastate revenue requirement from a traditional settlement pool to the CHCF-A program, representing 30% to 80% of the small LECs intrastate revenue requirement.

5. The CHCF-A program requires the small LECs to comply with a rate increase requirement, a means test, and a waterfall provision.

Conclusion of Law

There is no longer a need to keep this rulemaking proceeding open.

O R D E R

IT IS ORDERED that:

1. A rate case plan for the small Local Exchange Companies (LECs) with scheduled cost-of-service reviews shall not be established at this time.
2. The Commission's Telecommunications Division shall monitor the operations and earnings of CenturyTel of Eastern Oregon, Inc. on a yearly basis and upon the appearance of an in-balance between the operations and earnings of the small LEC and its ratepayers prepare a proposed investigation into the operations and earnings of the small LEC for Commission consideration.
3. Rulemaking 97-06-038 is closed.

This order is effective today.

Dated November 8, 2001, at San Francisco, California.

LORETTA M. LYNCH
President
RICHARD A. BILAS
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

Commissioner Henry M. Duque, being necessarily absent, did not participate.